BEFORE THE

POSTAL RATE COMMISSION

Docket No. R2000-1

POSTAL RATE AND FEE CHANGES, 2000

JOINT BRIEF

CONCERNING THE REVENUE REQUIREMENT

OF

THE DIRECT MARKETING ASSOCIATION, INC.
ADVO, INC.
ALLIANCE OF INDEPENDENT STORE OWNERS AND PROFESSIONALS
ALLIANCE OF NONPROFIT MAILERS
AMAZON.COM, INC.
AMERICAN BUSINESS MEDIA
AMERICAN LIBRARY ASSOCIATION
ASSOCIATION FOR POSTAL COMMERCE
ASSOCIATION OF PRIORITY MAIL USERS, INC.
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
FLORIDA GIFT FRUIT SHIPPERS ASSOCIATION
MAGAZINE PUBLISHERS OF AMERICA
MAJOR MAILERS ASSOCIATION
THE MCGRAW-HILL COMPANIES, INC.
PARCEL SHIPPERS ASSOCIATION
TIME WARNER INC.

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CONCERNING THE REVENUE REQUIREMENT

I. INTRODUCTION

The Direct Marketing Association, Inc. ("The DMA") and the other signatories hereto (referred to collectively as the "Consortium")[1] respectfully submit this joint brief, which sets forth our views on several important issues affecting the size of the revenue requirement requested by the Postal Service. A careful review of the record demonstrates that the Postal Service has overstated its revenue requirement by at least $1.3 billion. In particular, the Service has: (1) requested a contingency that is unreasonable and not supported by substantial evidence; (2) failed to correct a flaw in the cost reduction estimates generated by the rollforward program for supervision of clerks/mailhandlers and city delivery carriers; and (3) underestimated the cost savings from installing the Advanced Flat Sorting Machine ("AFSM 100"). In the proper

[1] The members of the Consortium are The Direct Marketing Association, Inc.; Advo, Inc.; Alliance Of Independent Store Owners And Professionals; Alliance Of Nonprofit Mailers; Amazon.com, Inc.; American Business Media; American Library Association; Association For Postal Commerce; Association Of Priority Mail Users, Inc.; Coalition of Religious Press Associations; Dow Jones & Company, Inc.; Florida Gift Fruit Shippers Association; Magazine Publishers Of America; Major Mailers Association; The McGraw-Hill Companies, Inc.; Parcel Shippers Association; and Time Warner Inc.

exercise of its statutory authority and responsibility, the Commission should reduce the Postal Service's revenue requirement accordingly. The adjustments proposed by the Consortium are summarized in the following Table:

TABLE 1

TEST YEAR AFTER RATES

REVENUE REQUIREMENT ADJUSTMENTS

	USPS ($Thousands)	DMA ($Thousands)	ADJUSTMENT ($Thousands)
Contingency	$1,679,766	$ 668,978	$ (1,010,788)
Rollforward Flaw		(92,943)	(92,943)
AFSM 100	169,379	371,510	(202,131)
Total			$ (1,305,862)

II. THE PROPOSED CONTINGENCY SHOULD BE SUBSTANTIALLY REDUCED.

Under the Postal Reorganization Act of 1970 (the "Act"), the revenue requirement should include "a reasonable provision for contingencies." 39 U.S.C. § 3621. In this case, the Commission has been presented with an array of testimony demonstrating that the 2.5% contingency allowance proposed by the Postal Service, which on a percentage basis is two-and-one-half times greater than the contingency in R97-1, is excessive. For the reasons stated herein, the Commission should reduce the Postal Service's request and approve a contingency of no more than 1% of USPS costs. If the Commission utilizes the updated cost estimates presented in the USPS supplemental testimony filed on July 7, 2000, pursuant to Order No. 1294, the provision for contingencies should not exceed 0.25%.[2]

A. The Commission Has the Legal Responsibility to Approve a Provision for Contingencies No Larger than the Commission Determines to be Reasonable.

Postal Service witness Strasser suggests that any reduction by the Commission of the contingency provision requested by the Postal Service would be an "unlawful intrusion into the policy-making domain of the Board." Tr. 46/20184. This statement is simply erroneous. As the Supreme Court has stated, under the Act "ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission." *National Ass'n of Greeting Card Publishers v. U.S.P.S,*, 462 U.S. 810, 821 (1983) (quoting S. Rep. No. 91-912, p. 4 (1970) (Senate Report)). Moreover, the law is clear that Postal Service revenue estimates may be adjusted as long as the Commission does so for valid reasons and bases its conclusions on substantial evidence in the record. *E.g., Mail Order Ass'n v. U.S.P.S.*, 2 F.3d 408, 420 (D.C. Cir. 1993) (stating that Commission revenue adjustments will be upheld if it is based on "such relevant evidence as a reasonable mind might accept as adequate to support the conclusion" (internal quotation marks omitted)). Thus, it is well within the scope of the Commission's authority, and it is the Commission's responsibility, to base its recommended decision on an estimate of revenues needed in the Test Year, including a provision for contingencies no larger than the Commission determines to be reasonable.

The case on which Strasser presumably relies, *Newsweek, Inc. v. U.S.P.S.*, 663 F.2d 1186 (2d Cir. 1981), *aff'd sub nom. National Ass'n of Greeting Card Pubs.*, 462 U.S. 810, involved a unique set of circumstances that bear no resemblance to the instant case. In *Newsweek*, the Court held that the Commission's decision to reduce the Service's revenue

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[2] Certain members of the Consortium are also members of the Periodicals Mailers Group and are (continued...)

requests, including the contingency provision, was unlawful because it constituted an attempt to "punish" the Postal Service for its refusal to file rate cases as frequently as the Commission wanted. *Id.* at 1204. This action was deemed arbitrary by the Court because it "had the effect of undermining the Board's exclusive authority in timing changes in postal rates." *Id.*

The *Newsweek* decision, however, did not in any way modify the Commission's authority to determine, within the constraints of the record in each proceeding, the size of a reasonable contingency. The Commission discussed at some length the implications of the *Newsweek* decision in the succeeding omnibus rate case, R84-1, and concluded:

> the Commission has both the authority and the responsibility to make adjustments in the Postal Service's proposed revenue requirement, so long as our adjustments are not arbitrary, our reasoning is fully articulated and based upon substantial evidence in the record, and where our adjustments have neither the intent nor the effect of causing more frequent rate filings nor constitute an intrusion into the policy-making domain of the Board in accordance with the holding in Newsweek.[3]

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filing a separate brief that supports a zero contingency for the Periodicals class.

[3] PRC Op. R84-1 at 25. In past cases, the Postal Service has argued that <u>any</u> reduction in the USPS-requested revenue requirement (including the contingency) would be unlawful, because it would have the effect of causing the next rate case to be filed sooner than it would have been otherwise. This assertion is dubious, given the Postal Service's strong financial position, *see, e.g.*, Strasser, Tr. 46/20230, 20234-36, and its great flexibility in managing its finances. Even if it were true, however, it would not impede the Commission from exercising its responsibility to determine a "reasonable" contingency. A careful reading of the Commission's Opinion in R84-1, and the Court's decision in *Newsweek,* reveals that, before it improperly impinges upon USPS managerial authority, a Commission reduction in the requested revenue requirement must "<u>necessarily</u> have the effect" of causing more frequent rate filings. PRC Op. R84-1 at 25 n.17, *citing Newsweek*, 663 F.2d at 1204. The meaning of "necessarily" must be seen in the (rather extreme) context of the R80-1 case. The *Newsweek* court focused on the Governors' assessment that the Commission's reduction was so severe that "even in the short term, the Commission's recommendation simply would not yield enough revenues to cover postal costs, [leading] to a rate filing as soon as possible by the Postal Service." *Id., quoting* Governors' Decision at 7. The facts of the R2000-1 case, and the extent of the reduction in the USPS-requested contingency advocated by the Consortium, are totally different.

Since R84-1, the Commission has reduced revenue requests and contingency requests when it concluded that the evidence of record merited such reductions. *E.g.*, *United Parcel Serv., Inc. v. U.S.P.S.*, 184 F.3d 827, 832-33 (D.C. Cir. 1999) (noting that the Commission in R97-1 approved a provision for contingencies of 1%, in spite of a USPS request for a contingency of 1.5%).

There is no issue of Postal Service managerial discretion involved here.[4] None of the modifications to the USPS-requested revenue proposed in this brief runs afoul of *Newsweek* or its rationale. The question is whether the Postal Service has offered sufficient evidentiary support for its revenue request. The Commission should exercise its statutory responsibility;[5]

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4 Strasser makes a half-hearted suggestion that a reduction in the proposed contingency request would unduly interfere with the Postal Service's policy decision to reduce its outstanding debt. Tr. 46/20192. This contention is without merit. The provision for recovery of prior year losses, which is not at issue here, is designed for and can accommodate that policy decision. A proper contingency request must therefore be based on other considerations. Moreover, the Board has not articulated any policy or judgments relating directly to the extent of the risk that it considers current economic conditions present. His protestations in his prepared testimony to the contrary notwithstanding, *e.g.*, *id.*, Strasser had to admit on cross-examination that the Board had not made any statements or articulated any policies on this point. Tr. 46/20214-16.

Even if the Board had made an explicit policy decision concerning the size of the contingency provision, that decision should not influence the Commission's determination based on the evidence of record. The Act provides a specific mechanism for resolving differences of opinion between the Commission and the Board on the subject of the revenue requirement. It is set forth in section 3625 of the Act and requires that the Governors return the Commission's initial recommended decision for reconsideration. If the Commission does not change its mind, the Governors can then modify the Commission's determination, but only upon a <u>unanimous</u> determination that the Commission's recommendation does not provide sufficient total revenues.

At the current stage of this case, therefore, the Act envisions that the Commission will reach its own, independent judgment as to the size of a "reasonable" provision for contingencies.

5 The Commission should not lose sight of the fact that it is an <u>independent</u> regulatory agency. *See Direct Marketing Ass'n, Inc. v. U.S.P.S.*, 778 F.2d 96, 99 (2d Cir. 1985). It was created for the express purpose of providing a check on the postal management in all rates and classification matters, for the express purpose of NOT allowing postal management to exercise unilateral discretion in these areas, including the critical issue of how much money the USPS needs to break even in the Test Year.

carefully consider the evidence of record; and include in the revenue requirement a contingency provision that it determines to be reasonable.

B. A Reasonable Contingency Must be Based on Substantial Record Evidence and Should Cover Only Unforeseen Expenses and Forecasting Errors.

The principles that should be utilized to determine the size of a reasonable contingency are now well-settled. First, a contingency should provide the Postal Service with a reasonable cushion against the risk of unforeseen expenses and forecasting errors. Second, the basis for the contingency must be articulated based on substantial evidence in the record. A "reasonable" provision for contingencies cannot be based simply on subjective "judgment;"[6] nor can it be based on management "policies" that are unrelated to its legitimate purpose.[7]

The need for a contingency as a reserve against unforeseen costs has been addressed in virtually every rate case. As far back as R76-1, the Commission stated that "[t]he general standard should be that expenses which could neither be foreseen nor prevented through the exercise of honest, efficient, and economical management are properly provided against by the creation of a contingency provision." Op. R76-1 at 52.

In R84-1, the Commission expanded upon this view:

> the purpose of the contingency provision set forth in 39 U.S.C. section 3621 is two-fold. First it provides insurance against the possibility of

[6] *E.g.*, Tr. 22/9709 ("Relying on management discretion to pick the contingency reserve will not guarantee its reasonableness.")

[7] For example, USPS witness Strasser argues that the contingency provision can properly be used to support the policy of the USPS Board of Governors to restore the equity position of the Postal Service. Tr. 46/20192. The Consortium respectfully submits that the Board's equity restoration policy (regardless of whether it is valid in the first place) is totally irrelevant to the size of a reasonable provision for contingencies. The revenue requirement has other money in it for this purpose, the recovery of prior year losses ("PYL"). If the Board determines that the "equity" as shown on the books of the Postal Service is too low for some reason or is not being recovered rapidly enough, it should explicitly so state, and request the Commission to increase the PYL amount.

> misestimates of test year accrued revenues and expenses. As we have stated in the past, such variances are inherent in the forecasting process. Second, the provision is intended to protect against unforeseeable events, not capable of being prevented through honest, efficient, and economical management, and which might have a significant adverse impact on the financial position of the Service or its operations.

Op. R84-1 at 52; *see* Op. R87-1 at 35-36. Based on the Commission's prior analysis, it follows that shortfalls that could be foreseen by the exercise of sound management are not properly included in a contingency request. *See* Op R94-1 at II-14 (stating that an "anticipated development cannot properly be included among the 'unforeseen adversities' for which the contingency provision is intended to provide").

To justify a contingency provision of a particular size, the Commission has repeatedly stated that the Postal Service must offer more than just its managerial intuition about potential unforeseen financial risks. This concept was fully developed by R87-1:

> [t]he Postal Service argues that unforeseeable risks, because they are unknown, by their very nature cannot be articulated or analyzed, but must remain in an intuitive realm. But in our view, if such risks are to be the predominant basis of the Postal Service's contingency determination, management's perception of those risks must be articulated to a reasonable degree in order to satisfy the substantial evidence requirement.

Op. R87-1 at 36. Thus, the Commission has looked to more objective criteria such as a variance analysis, the financial condition of the Postal Service, and the general state of the economy to assess a proposed contingency. *E.g.,* Op. R94-1 at II-13; Op. R76-1 at 53-57. While none of these individual factors is dispositive, each has an important role in informing the Commission's exercise of its discretion. *E.g.,* Op. R84-1 at 27; Op. R80-1 at 21-22.

Evaluating a request for funds to cover unforeseen financial hazards is inevitably a matter of judgment that cannot be reduced to a set formula. Nevertheless, an examination of the Commission's approach to the contingency makes clear that a reasonable contingency must reflect the degree of financial uncertainty facing the Postal Service and must be based on fully-articulated principles drawn from the record. With these tenets in mind, we now turn to an evaluation of the Postal Service's R2000-1 contingency proposal.

C. The Postal Service Has Not Justified Its Exorbitant Contingency Request.

In support of its request for $1.68 billion contingency, the Postal Service initially offered the testimony of Witness Tayman. Tayman's "argument" in favor the contingency was based almost entirely on his subjective opinions or on entirely foreseeable factors that are not a valid basis for a contingency request. Due to the inadequacy of Tayman's effort, the Postal Service turned to Witness Strasser in a last-minute attempt to support the unsupportable. But neither Tayman nor Strasser's arguments in support of a 2.5% contingency withstand scrutiny.

1. Witness Tayman.

Witness Tayman's justification of a 2.5% contingency is limited to a mere 3 pages of his testimony, USPS-T-9 at 43-6, and the bulk this limited treatment is devoted to trying to explain why he did not rely on the variance analysis he presented.[8] As a result, only a brief description of Tayman's testimony on the proposed contingency is necessary, because his explanations are extremely vague and thus not amenable to careful analysis. Tayman openly

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[8] Tayman is totally unpersuasive when he tries to explain why he did not take his own variance analysis seriously into account when considering the appropriate size of a contingency. For example, he states, "I am convinced that variance analysis cannot be relied upon in a vacuum as the basis for determining an appropriate contingency level." USPS-T-9 at 45. He goes on to state that a variance analysis "should not be relied upon exclusively to determine the prudent amount of cushion against unforeseen events in the Test Year." *Id.* He is merely attacking a straw man. Neither the Commission nor any witness in this proceeding has suggested that a variance analysis should be relied upon exclusively. What the Commission has determined in the past is that a variance analysis is an important element in determining a "reasonable" contingency. The variance analysis contained in the record of this case strongly supports a rather small contingency, but it is not the sole support for that conclusion. There is certainly no justification for Tayman's refusal to take the variance analysis into account at all.

proclaims that the 2.5% contingency was based on a "largely subjective" determination. USPS-T-9 at 43. Consistent with his testimony, he provided no studies, data, or supporting information to support the contingency request, in spite of numerous requests from The DMA and the OCA.[9] As Witness Burns aptly comments, "[i]t is clear from the history of Commission proceedings that the Postal Service cannot justify a contingency reserve as being reasonable simply because management deems it so. Yet that is what [Tayman] has done in this case." Tr. 22/9715.

To the extent that Tayman puts forward any specific assertions to explain his subjective opinion, they involve primarily circumstances that are entirely foreseeable and therefore have no proper role in a contingency analysis. For example, Tayman claims a larger contingency is justified because (1) volume growth is below historical norms; (2) health benefits and other labor costs are increasing more rapidly than in the past; and (3) the Internet is making inroads into the Service's revenues. *See* USPS-T-9 at 44. Under questioning, however, Tayman conceded that all of these developments are already accounted for in the rollforward model.[10] In sum, all that Tayman offers the Commission is his personal conviction that the Postal Service needs a contingency of the requested size. That does not constitute substantial evidence and should be given little weight by the Commission

2. Witness Strasser.

In the wake of Tayman's failure to support the contingency request, Acting CFO Strasser presented rebuttal testimony that attempted to offer a more comprehensive explanation

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[9] Tr. 2/280-81, 84; *id.* at 2/385-86.

[10] Tr. 2/280; *see* Tr. 22/9820-21. Moreover, Tayman conceded to Chairman Gleiman that $450 million of the contingency was intended to cover the fact that new rates are not expected to go into effect until several months into the Test Year, a fact that is irrelevant to the size of a "reasonable" contingency provision. Tr. 2/561-63.

of the Postal Service's proposal. But he fares no better. Strasser's reasoning is either duplicative of Tayman's already dubious testimony or is belied by other statements made by Postal Service witnesses. Thus, Strasser does not help the Service meet its substantial-evidence burden.

First, Strasser contends that a 2.5% contingency is justified because it is well-within the range of the contingencies approved in prior rate cases. Tr. 46/20183-184. This point is unpersuasive for several reasons. First, a contingency request must be based on record evidence in the pending proceeding, not on extrapolations of past cases. Contingencies approved a decade or two ago in an era of volatile inflation, oil embargoes, high budget deficits, and political uncertainty cannot be meaningfully cited under present circumstances. *E.g.,* Tr. 22/9816-17. Recent rate cases are a more appropriate benchmark of comparison, and in both R94-1 and R97-1, the contingency approved by the Commission was much lower than the 2.5% proposed here.

Second, Strasser suggested that there are uncertainties in the general economy that support a large contingency. Tr. 46/20189-191 USPS witness Zarnowitz has also suggested that the robust economy of recent years has created imbalances that pose the risk of higher inflation or a slowdown.[11] Even if one worries that the most stable economy in a generation is destined to deteriorate eventually, these fears are exaggerated insofar as they relate to the Test Year (*i.e.*, the next 13 months). For example, Zarnowitz concedes that economic forecasts are quite reliable over a one-year period, and that only after two years do they become seriously suspect. Tr. 41/18234; *see id.* at 41/18308. Moreover, neither Strasser nor Zarnowitz ever explains why the

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[11] *See* Tr. 41/18190. Dr. Zarnowitz fails to mention the fact that these two potential adverse developments would offset each other. In other words, if unemployment shrinks (thereby putting upward pressure on USPS labor costs), it is likely to be accompanied by strength in the overall (continued...)

economic risks they are worried about are not already reflected in the Postal Service's Test Year estimates. Indeed, as recently as July the Postal Service produced new ECI numbers that account for the evolving economic circumstances that trouble Strasser.[12] Despite this effort to fine-tune its estimates of Test Year financial performance, the USPS has <u>not</u> modified its contingency request.[13] For the foregoing reasons, uncertainty in the general economy cannot support the large contingency requested by the Postal Service.

Third, Strasser argues that the Postal Service needs a higher contingency to restore equity. Tr. 46/20199-200. Even if restoring equity were an important policy goal,[14] that goal could not support a contingency request, because equity restoration is not an unforeseen expense. To the extent that Strasser is suggesting that the Service needs a large contingency to guard against the need to borrow more money, that is the appropriate function of the prior-year-

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economy (helping to boost USPS volumes and revenues). The reverse is also the case. *E.g.*, Tr. 46/20259-260.

12 *See* USPS-ST-44 at 2-3. The implication of this testimony is that the Postal Service does not put much faith in the inflation and other estimates produced by DRI, which the Postal Service uses in both its volume and cost forecasting. Such lack of faith is inexplicable given the substantial extent to which the Postal Service relies on DRI numbers throughout its presentation.

13 Strasser argues that the new ECI numbers show that the Postal Service needs more revenue and therefore justifies the 2.5% contingency proposal. *See* Tr. 46/20203-206 Just the opposite is true. By reducing the Postal Service's uncertainty about future costs, the ECI numbers reduce the need for a large contingency. Strasser's conclusion is also belied by the fact that the Service has made no effort to modify its contingency request in light of the new numbers. If the situation was as Strasser describes it, then one would have expected the Service to increase its contingency proposal rather than leaving it unchanged.

14 For purposes of the present discussion, the Consortium takes no position on the merits of this policy goal. The Consortium would like to point out, however, that the financial posture of the Postal Service is, in fact, substantially stronger than its financial "books" would indicate, because, inter alia, its substantial real estate holdings are carried at cost, and therefore do not reflect their current market value. *E.g.*, Strasser, colloquy with Commissioner Covington, Tr. 46/20355. The Consortium would also like to point out that the decision to request a contingency of 2.5% in the context of the USPS' supplemental testimony filed on July 7, 2000 was never considered by the Board, Tr. 46/20220, and therefore is not entitled to deference as a policy decision of the Board.

loss recovery provision, not the contingency.[15] *See* Tr. 22/9809. Accordingly, this rationale does not support the Postal Service's proposal.

The only two witnesses supporting a 2.5% contingency have failed to advance a single persuasive argument. All of the concerns expressed about the "challenges" facing the Postal Service in the near-future are either already accounted for or are hyperbole. Thus, the Service's contingency proposal should be rejected.

D. The Commission Should Approve a Contingency Provision No Greater Than One Percent.

The Postal Service not only has failed to provide substantial evidence to support its request for a 2.5% contingency, but extensive evidence in the record also supports a much lower number. For the reasons stated below, the Commission should include in the revenue requirement a contingency provision no larger than 1% of total estimated costs.

1. A Reality Check: The Postal Service May Easily Break Even in FY 2001 Without Any Rate Increase.

Traditionally, this Commission has used a rather complex process to make its estimate under section 3621 of the amount of revenue that will allow the Postal Service to break even in the Test Year. This process has started with actual, audited numbers from a "Base Year" which are then "rolled forward" to the Test Year by applying adjusting factors such as cost level, volume, non-volume workload, cost-reduction programs and the like. The Consortium does not suggest that the Commission change this methodology in the current case.

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15 In this case, the Consortium does not dispute the Postal Service's request to the extent that it contains, as it has in every case for the past two decades, a substantial amount representing PYL. The Consortium would point out, however, that this number, which was raised to $311 million in the Postal Service's supplemental testimony, see Exhibit USPS-ST-44A, represents a substantial amount that mailers are being asked to pay in excess of anticipated Test Year expenses.

However, this process is not mandated by the Act, and there is a much simpler way for the Commission to approximate what the USPS finances for the Test Year will look like. This alternative approach has been described by DMA witness Bernheimer. Although the Postal Service chose to file its case using FY1998 as its "Base Year," actual, audited FY1999 figures became available during the pendency of the case, and actual FY2000 numbers through AP12 became available shortly before the hearings concluded. Thus, FY2000 results are nearly complete, and the final numbers can be estimated merely by estimating FY2000/AP13 and estimating the adjustments referred to as "AP14." Then, Test Year results can be estimated merely by making a projection only 12 months into the future. Tr. 46/20436-437.

As Mr. Bernheiner demonstrated, and as USPS Acting CFO Strasser admitted, the Postal Service will break even, or will nearly break even, in FY2000. Tr. 46/20426; *id.* at 46/20255. Moreover, there is a reasonable scenario under which the Postal Service will also break even in FY2001 without any rate increase whatsoever!!

Through the end of FY2000/AP12, the Postal Service has realized net income of \$226.1 million. AP13 is typically a "slow" period as far as mail volume is concerned, and based on history it is likely to show a loss. As Bernheimer pointed out, however, AP13 losses have averaged less than \$300 million over the past seven years; in one year they slightly exceeded \$500 million, but in another year they were barely more than \$100 million. *Id.* at 46/20467. The AP14 adjustments are calculated by adding USPS results during the last several weeks in September, subtracting the results from the similar period in 1999, and making any other adjustments required by generally accepted accounting principles. Thus, even though September is also a "slow" period, these adjustments may have a positive effect on FY2000 results, if they are better than the same period in 1999. In any event, FY2000 results are not likely to show a loss of more than a couple of hundred million dollars, a number that is actually rather modest in comparison to the $64 billion size of the USPS budget. Thus, it is fair to summarize that the Postal Service is likely to "break even or almost break even" in FY2000.

What can be said, then, about the likely results in FY2001? As Bernheimer demonstrated, there is a reasonable scenario under which the Postal Service will also break even next year without any rate increase. The estimated difference between expense growth and volume growth in FY2000 is 1.4%.[16] Moreover, the average difference between expense growth and volume growth over the past 7 years is 1.3%. Tr. 46/20424. Applying a 1.4% differential to estimated FY2000 total expenses of $64.5 billion produces a net revenue shortfall of less than $1 billion. The Postmaster General has already announced the Postal Service's intention to cut costs by $1 billion during FY2001. Thus, under this scenario,[17] the Postal Service would break even during the Test Year even if the Postal Service were to operate under the current rate structure.

2. Another Reality Check: Rate Increases Hurt!

The Postal Service may argued that the Commission should err on the side of a large contingency on grounds that, if it is not needed, mailers will benefit through a likely postponement of a subsequent rate increase. Such an argument totally ignores the voluminous testimony in this record from mailers who have explained the serious financial consequences that the USPS-proposed rate increases would have. It is contrary to the oft-stated mailer preferences for smaller, more frequent rate increases, as opposed to larger, less frequent increases. And it

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16 Expense growth of 3.9% minus volume growth of 2.5%. Tr. 46/20422.

17 The Postal Service claims that next year will be "challenging." USPS-T-9 at 43. Perhaps. But the Postal Service succeeded in saving $1 billion this year when they put their mind to it. Tr. 46/20465.

ignores that fact that, even in the past decade, when the Postal Service has had strong financial results, rate cases have been filed more and more frequently.[18]

Moreover, there is no basis for assuming that smaller or later rate increases in the future will offset the current harm. To the extent that the increased revenue produces higher compensation packages for labor (or higher prices for any other inputs), the pool of surplus income available to hold down future rate increases will simply be shifted to suppliers of inputs rather than returned to ratepayers. Moreover, today's mailers are not the same as tomorrow's: Even if future savings fully offset the current excessive increase, the result would be a subsidy of future mailers by current mailers.

The fact of the matter is that a postal rate increase of any size has a significant impact on the budgets of virtually every postal customer. Postal rate increases have real-life consequences: they force mailers to raise the prices they charge for the goods or services they sell; price increases may cause them to lose customers; and customers lost may never be regained. The very practical problems that would be caused by the rate increases proposed by the Postal Service in this case have been the subject of much testimony on this record. For example, CRPA witness Stapert testified that nonprofit periodicals have recently been hit with: (1) the R97 rate increase; (2) higher costs due to the end of the final revenue foregone subsidy; and (3) additional printing and software costs as a result of the reclassification in MC96-2. Tr. 30/14446. Now the Postal Service wants a substantial contingency, which means that "[p]eriodicals will pay double digit rate increases in large part because USPS cannot budget

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[18] The R94-1 rate case was filed 1,463 days after the filing of the R90-1 case; the R97-1 rate case was filed 1,220 days after the filing of the R94-1 case. The R2000-1 rate case was filed 914 days after the filing of the R97-1 case.

expenses competently for a test year, 2001, that begins in a little more than six months from now." *Id.* at 30/14436.

Without attempting to provide a thorough summary of the testimony on this general subject, suffice it to say that, clearly, the proposed rate increases will cause real-life pain for the mailers and their customers, who must dig into their pockets to pay them. The Commission should ameliorate this pain as much as possible. It certainly should not "err on the side of a larger contingency." It should recommend a reasonable contingency, and not one penny more.

3. A Provision for Contingencies Greater Than 1% would be Unreasonable.

As discussed above, the Commission has developed over the past 30 years a fundamentally sound method for determining a "reasonable" provision for contingencies. This determination should be made by taking into account a number of factors, including the variance analysis, the financial condition of the Postal Service, economic conditions in general, and the degree of confidence that the Commission has in the USPS estimates for the Test Year.

The Postal Service undertook a variance analysis of the type that the Commission relied upon in prior cases.[19] Inexplicably, however, the Postal Service ignored this important factor when it reached the point of developing a request for a provision for contingencies in this case.[20] Witness Buc has explained, in unrebutted testimony, that "unlike either of the last two

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19 For a discussion of the USPS variance analysis, *see* Tr. 22/9543-44.

20 *See* Tr. 22/9821-22. In his rebuttal testimony, USPS witness Strasser tried to rationalize the Postal Service's failure to take the variance meaningfully into account in this case. He stated, for example, that the Commission "disclaimed necessary reliance on quantitative methods." Tr. 46/20186. He claimed further that "Postal Service management does examine historical trends and performs objective and quantitative analyses [which] aid judgment in selecting the contingency." *Id.* at 46/20187. This *ex post facto* rationalization is belied by the fact that the (continued…)

[rate] cases, witness Tayman has proposed a contingency higher than any of the variances produced by the variance analysis." Tr. 22/9543; *see also id.* at 22/9822-24. In R97-1 the contingency proposal was within the range covered by the variance analysis, and in R94-1 the proposal was smaller than the one produced by analysis. Tr. 22/9544. Thus, proper consideration of the variance analysis should lead to a lower contingency.

Second, the Postal Service is in substantially better financial shape than it has been for many years, and arguably better than it has ever been.[21] This improved condition gives it greater flexibility to respond to unexpected reversals of the current stable conditions. For example, it could file a new rate case seeking increased rates to respond to whatever condition might arise on short notice, and it would have adequate financial strength simply to absorb the unexpected losses while its request is considered by the Commission. Moreover, instead of funding its capital investments from operating revenues as it does currently, it could finance them in the manner used by most businesses: borrow the needed funds and spread the cost over the appropriate amortization period. Tr. 46/20454-455.

Third, the contingency should be lowered to reflect the general strength and stability of the U.S. economy as a whole. There is no need to recite the strong economic

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Postal Service's request for a contingency is totally outside the scope of the Postal Service's own variance analysis.

[21] When initially created, the Postal Service's balance sheet reflected a positive equity representing the value of the assets contributed by the U.S. Government. Today, its books show a negative equity of approximately $468 million at the end of AP12. Tr. 46/20224. However, this number reflects neither the fact that the Postal Service has paid off almost $5.5 billion of debt since the end of 1993 and invested almost $20 billion in capital assets during the period 1993-2000AP12. Tr. 46/20236. Moreover, the balance sheet does not reflect the extent to which the USPS assets have increased in actual value since 1970. Finally, the current economic environment is characterized by substantially reduced inflationary pressures as compared with the early-to-mid 1970's. Tr. 22/9812; *see generally* Tr. 46/20283-291.

performance that the United States has seen over the past several years. *See* Tr. 22/9544-47; *id* at. 22/9812-14. This low-inflation, high-growth environment has helped the Service restore $4.8 billion in equity over the past two rate cycles and to finance nearly $20 billion of capital investments from operating revenue.[22] Contrary to the suggestions of the Postal witnesses, there is nothing to indicate that the economy as a whole will defy the economic forecasts (including the DRI forecasts used by the Postal Service to forecast expenses and revenues) and suddenly experience significant problems over the next 13 months.

In an apparent attempt to raise doubts on the preceding point, however, the Postal Service presented rebuttal testimony by Dr. Victor Zarnowitz, an experienced and respected expert in the field of economic forecasting. Tr. 41/18187. Dr. Zarnowitz concluded that, "Hence, there is more uncertainty now than before about the forecasts of the economy in the years ahead." Tr. 41/18212. This statement does not exactly sound a serious alarm about likely economic developments during the period of time relevant to the current discussion: the 13 months until the end of the Test Year.[23] He had to admit, moreover, that he had a reasonable degree of confidence in forecasts for the next one-to-two years, a period of time that includes (with substantial room to spare) the Test Year. Tr. 41/18234. Moreover, just prior to Dr. Zarnowitz' appearance on the stand the Open Market Committee of the Federal Reserve Board determined not to raise the Federal discount rate, and it issued a statement in which it concluded,

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[22] *See* Tr. 22/9545; Tr. 22/9815. *See also* Tr. 46/20454.

[23] Actually, Dr. Zarnowitz devoted the bulk of his testimony to attacking a "straw man:" the proposition that witnesses Buc, Burns and Rosenberg base their views on the contingency on the judgment that the nation is experiencing a "New Economy," which will be characterized by an absence of business cycles and "indefinite prosperity." Tr. 41/18189; *see generally* Tr. 41/18189-208. Witnesses Buc, Burns and Rosenberg make no such claim, and their views on the appropriate size of a "reasonable" provision does not depend on the view of the general economy erroneously attributed to them by Dr. Zarnowitz.

> Recent data have indicated that the expansion of aggregate demand is moderating toward a pace closer to the rate of growth of the economy's potential to produce. The data also have indicated that more rapid advances in productivity have been raising that potential growth rate as well as containing costs and holding down underlying price pressures.

Id. at 41/18247.

USPS witness Strasser also cites concerns about the general state of the economy in support of a large provision for contingencies. USPS-RT-1 at 8, 9-11. His remarks are wholly subjective and conclusory, however, and he adds nothing of substance to the analysis presented by Dr. Zarnowitz.[24] Thus, the Postal Service's claim that there are significant economic uncertainties in the near term is without merit.

Finally, a large contingency could have a tendency to lead to less efficient management. *See* Tr. 22/9826-27. This is not an attack on the dedication of postal managers. Rather, it is a simple statement of the principle of "moral hazard," which holds that the existence of insurance can create an incentive for the insured to engage in riskier behavior because he or she knows that losses will be covered. Providing the Postal Service with a large contingency will reduce the incentive for managers to find other cost savings and develop better mail-handling processes. If a large contingency were justified on other grounds, then this moral hazard risk might be a necessary cost. In this case, however, there is no justification for the 2.5% contingency and so moral hazard concerns become much stronger.

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[24] Strasser does make one analytical error. He claims that the higher inflation estimates made by DRI and included in the Postal Service's 1294 filing indicate a greater "volatility," which in turn "supports the need for a larger contingency." Tr. 46/21190. A simple increase in the level of inflation, especially one of the modest size reflected by the DRI numbers, is not indicative of increased volatility. "Volatility" denotes a series of increases and decreases within a short time frame. There is no evidence of record that our economy is experiencing volatile inflation rates. In this respect, it is instructive to review Figure One presented by OCA witness Rosenberg, Tr. 22/9812, which shows inflation rates since 1970. The volatility of these rates during the 1970s and early 1980s is contrasted with the relative stability of these rates during the late 1980s and the 1990s. *See id.*

The Commission has the authority and the duty to review the proposed contingency request. Upon such a review, the record is clear that the Postal Service's request is unreasonably high. Based on the evidence of record in this proceeding, the Commission should include in the revenue requirement a provision for contingencies no greater than 1%.

4. If the Commission Projects Test Year Costs Using Up-Dated Estimates, the Contingency Should Not Exceed 0.25%.

On July 29, 2000, the Postal Service filed supplemental testimony in response to Commission Order 1294. In addition to presenting the financial results for FY1999, the Postal Service also up-dated a number of the factors that have an important impact on Test Year estimated costs created by rolling forward actual costs into the Test Year. These factors included a more recent estimate of the Employment Cost Index prepared by DRI. USPS-ST-44 at 2-3.

In his Supplemental Testimony filed on August 14, 2000, DMA et al. witness Buc considered the implications that the USPS supplemental testimony had on size of a contingency that would be reasonable in light of the up-dated actual financial results and the more recent estimates of future economic activity. Mr. Buc concluded that there are four reasons why the contingency to accompany the Postal Service's revised TYAR cost estimate should be only 0.25 percent: (1) the use of ECI for wage increases rather than ECI-1 reduces the risk of unforeseen expenses; (2) the revised cost estimates do not reflect the full savings the Postal Service has committed to achieving, so there is a high probability that costs in the Test Year will be less than those the Postal Service has estimated; (3) the timing of the new estimates reduces some of the risk inherent in the original cost estimate; and (4) the revised estimate shows that a smaller contingency is warranted. Tr. 38/17186.

Several witnesses have explained that the relative currency of the revised ECI and other numbers reduce the uncertainty facing the Postal Service, further reducing the need for a contingency. As Witness Buc summarizes: "[b]ecause the purpose of the contingency is to defray . . . unforeseen and unforseeable risks, this reduction of risk [by the ECI numbers] should be reflected in a reduced contingency." Tr. 38/17186. This sentiment has been echoed by a broad coalition of groups. Tr. 41/18308-309 (stating Rosenberg's view that "[t]he use of more recent, and therefore presumably more accurate, forecasts of the economic environment during the test year lowers the level of uncertainty and supports a smaller contingency provision than would otherwise be the case"); Tr. 38/17098 (stating Siwek's position that because of the new forecasts "one has every right to expect that the Postal Service's need to collect additional funds from Postal ratepayers to be maintained solely in the event of forecast errors has also declined").

III. THE USPS UNDERESTIMATES THE SAVINGS CREATED BY THE ROLLFORWARD PROGRAM FOR SUPERVISORS.

As in R97-1, the USPS has again significantly underestimated the cost savings generated by the rollforward model. Correcting this basic mistake would reduce the revenue requirement by approximately $93 million.

In R97-1, the Commission stated that, with respect to the rollforward program, Buc's observation that "supervisor's work hours and costs should go down when their managed employees' work hours and costs go down is both consistent with the technique the Postal Service has used in this case to project test year supervisor costs and essentially unrebutted." Op. R97-1 at 62. As a result, in R-97-1 the Commission agreed with Buc and significantly reduced the Postal Service's estimates of supervisor work hours and costs. *Id.*

Even though the USPS is using a rollforward program virtually identical the one at issue in R97-1, in this case the Postal Service has nevertheless declined to reduce supervisor work hours (and labor costs) accordingly. The Postal Service did so even though it realized that changes in craft labor induce corresponding changes in supervisor labor. As the USPS stated:

"for any substantial or prolonged change in the level of nonsupervisory employee effort for a given work activity, there will be an accompanying change in first-line supervisory requirements." Tr. 22/9548.

Accordingly, the Postal Service's position is erroneous substantially for the reasons stated in R97-1 and should be corrected.

IV. THE POSTAL SERVICE HAS UNDERSTATED AFSM 100 COST SAVINGS.

As part of his demonstration that the Postal Service's revenue requirement is too high, Buc shows that the Postal Service substantially understates the cost savings that will result from replacing both manual sortation of flats and sortation of flats on the flat sorting machine (FSM) 881 with automated sortation of that mail on the AFSM 100. Buc's presentation is methodologically superior to that made by the Postal Service and should be adopted. The criticisms of Buc's approach are superficial and analytically unsound. The Buc approach should be adopted by the Commission and the revenue requirement reduced by slightly more than $202 million.

A. The AFSM Cost Reduction Analysis Of Witness Buc Is Superior To That Presented By The Postal Service.

The presentation of USPS Witness Tayman on the quantification of Test Year cost savings associated with the AFSM program suffers from "confusion that has resulted from the presentation and revisions to USPS-LR-I-126." Tr. 2/319. Whatever one makes of Tayman's explanation for the springing and shifting numbers in the AFSM cost savings presentation, the numbers suffer a more profound disability. The source of these numbers precludes independent examination of the assumptions that lie behind them and, therefore, verification of their reasonableness:

> Q What I was really getting after, Mr. Tayman, was the source, whether empirical or analytic, of those numbers. Do you know?
>
> A I mean, the source – again, it's explained in 126. There are several phases of these programs where they talk about different levels of operational savings, and so the source of these – again, it came from the program managers and would be consistent with what's in our operational plans.
>
> Q And your answer would be the same, I take it, if I directed you to the table that is associated with your response to MPA/USPS-T9-1? That is, you don't have any direct number – any direct knowledge of the derivation of the average hours of saving per machine?
>
> A Again, that's – okay. It's based on the – from the program manager information. It's also based on deployment schedules. Obviously, you know, there's just not one standard average, there's certain returns at certain, you know, offices. And so what's reflected here is the average of all those together.

Tr. 2/492-93.

Kingsley also testified on the subject of the Postal Service quantification of AFSM cost savings, but the numbers remain impenetrable:

> Q Yes. But – I appreciate all that and I could sum all these things up and I would get the total number of savings, but I'm really looking for a different thing. I'm looking to understand how you got the numbers by which those savings numbers are calculated.
>
> I understand 173 machines, but those 173 machines are multiplied by different factors as one goes through 126 and totes up references to AFSM 100 efficiencies, and it's --
>
> A. Right, based on the amount of deployment et cetera.
>
> Q. Okay, But it's the et cetera. Where else do I need to look to understand those numbers?
>
> A. It's my understanding these numbers were provided by the program managers under Mr. Tayman's direction. I am not familiar with all the background behind these numbers.

Tr. 5/1989-90

The Commission is entitled to greater rigor than this. It is not sound practice to accept cost saving estimates from program managers when more quantitative estimates are available from record evidence. Mindful of this, Buc set about to re-calculate the anticipated cost savings through the very direct and testable (because the assumptions are explicit) calculation displayed in Attachment C, page 3 of 3 of his testimony. Tr. 22/9558. Buc's calculation shows Test Year cost savings associated with the AFSM program of $371,510,000, or $202,131,000 more than that estimated by the Postal Service. Tr. 22/9556. *See also* Tr. 28/17149-50 (Witness Patelunas confirming that Buc correctly reflected the Postal Service's projected savings.)[25]

B. USPS Witness Patelunas' Criticism of Buc's Presentation Are Not Well Founded.

Rebuttal testimony sponsored by Postal Service witness Patelunas is " . . . critical of what Buc had to say." Tr. 38/17148. His criticism is extremely superficial and does not withstand even moderately close examination.

For example, he criticizes Buc's use of 166.5 as the "Number of Machines" in the Test Year, Tr. 22/9558, ". . . because not all Phase I machines will be deployed for the entire Test Year," Tr. 38/17146. When asked, Patelunas conceded that he had not troubled to examine the basis for this number. Tr. 38/17151. In fact, Postal Service witness Smith used this number as the basis for calculating the Test Year space costs for AFSM 100s. Tr. 7/3022-23; 38/17152-

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[25] There is a further difficulty with the Postal Service's numbers. Although Tayman appears to be the "official" USPS witness of AFSM cost savings in the Test Year, Smith made an estimate of this number for his own calculation of purposes. *See* Tr. 7/2963; *id.* at 7/2018-21 (Smith explanation of his estimate.) Smith's number, $274.8 million, is very different than the (continued...)

53. It is the average of the 158 machines Smith believed would be in place at the beginning the Test Year and the 173 machines that would be in place by Test Year end. USPS LR-I-83 at page I-12.[26] Patelunas is right in asserting that "change can [not] be precisely planned for and results perfectly anticipated." Tr. 38/17146. Projections into the Test Year are, however, an intrinsic aspect of the rate making process. Smith projected that there would be, on average, 166.5 AFSM 100s in the Test Year for purposes of calculating the space costs of that equipment. If it is fair to ask the Commission to credit that cost calculation, it must equally be fair to permit Buc to rely on that number for the purpose of calculating cost savings.

Patelunas also relies on some version of his uncertainty theory in his criticisms of the assumptions employed in the Buc calculation concerning the number of hours per day that the AFSM 100s will be in operation (taken from Kingsley's testimony), the operation of the machines 313 days per year (also from Kingsley) and the assumption of 15,000 units per hour productivity (Kingsley testified to a productivity of 17,000 units per hour at Tr. 5/1965). Patelunas' defense of this theory is not supported by facts. The following exchange is illustrative:

> Q And explain to me why you think those 158 machines that are in place at the beginning of the test year won't be operating efficiently.
>
> A They will still be experiencing the learning curve development of integrating the AFSM 100 into the operating environment.

$169 million associated with Tayman's testimony, although still substantially below Buc's estimate.

[26] The numbers are probably understated. As Kingsley testified, all 173 AFSM 100s from the Phase I purchase will be deployed by December of 2000. Tr. 5/1974. Thus, a time weighted average would yield a larger number of machines in the Test Year.

> Q And do you have specific facts that lead you to that conclusion, or are you just operating on sort of a Gestalt understanding that it takes time for things to happen?
>
> A I have spoken with the program managers and that is their explanation, and it is not a Gestalt, but it seems, to me, a reasonable assumption. As I mentioned at the bottom, I believe – yes, on the bottom of page 5, at line 22, even if you take all 173 machines and put them out there in the world, you don't instantaneously flip a switch and realize those savings. They do need to be integrated into the entire national network of moving the mail.
>
> Q But you can't quantify the extent to which there will be lag?
>
> A I can't quantify that.

Tr. 29/17161-62

All of the numbers in the Buc calculation were supplied by the Postal Service and many of them were used by the Postal Service in support of the rates requested in this proceeding. Patelunas' efforts to discredit them on the strength of such hazy argument as that set out above must be dismissed.

The three criticisms of Buc advanced at page 4 of Patelunas' rebuttal testimony, Tr. 38/17145, deserve no more credit. They are unacceptably vague, analytically wrong and, in at least one instance, factually impossible. The first characteristic is illustrated by this passage:

> Q And tell me how your would have had Mr. Buc alter his calculation to correctly reflect what you're criticizing him for not reflecting here. What should he have done differently? Look back at page 3 of 3 and tell me what numbers should have changed.
>
> A I don't know if I can sit here and provide a correction to this particular methodology. What I am critiquing here, what I'm criticizing is the combination of numerous optimistic ideal assumptions into one model. I can't – I don't have a correction to provide to this page that would somehow correct all these ideal assumptions that have gone into it.

Tr. 38/17155.

As an analytic matter, Patelunas either misapprehends the structure of Buc's presentation or has not thought through the point that he seeks to make. Buc has calculated cost savings that can reasonably be attributed in the Test Year to the increases in productivity associated with the Phase I AFSM purchase program.[27] He compares this with the number advanced by the Postal Service for Phase I AFSM cost savings. The fact that Buc's calculation does not account for certain new or increased costs that will or may be associated with the new machines is irrelevant.[28] As Patelunas conceded, the Postal Service cost savings number with which Buc makes his comparison does not contain such costs either. Tr. 38/17156-57. It is, then, analytically wrong to criticize Buc for not including in his measure of cost savings costs that are not included in the Postal Service number with which he is making his comparison.

One of these three criticisms by Patelunas of Buc's analysis has a further shortcoming still; it requests the factually impossible. Patelunas asserts that Buc's AFSM cost saving analysis should have included the increase in cost of allied labor associated with the new machines. The Postal Service has conceded that is has no information that would admit of such an assessment even were it analytically sound. Tr. 21/8310.

Patelunas is contradicted by another Postal Service witness concerning his "understand[ing] that the mail volume needed to optimize machine utilization may not be present

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27 As noted above, this is a conservative undertaking in that the Postal Service has acknowledged that some of the Phase II AFSMs will be in the field during the Test Year.

28 It is unarguable that there will be maintenance costs associated with the machines that have no direct counterpart in the manual sortation that the machines will replace. The machines will also occupy space in Postal Service facilities. Smith has accounted for this in Test Year costs. Indeed, he is almost certainly over-accounted for the space to accommodate the machines that he includes in his Test Year calculations because there is, in that calculation, no off-set for the decrease in space for manual sortation that will occur as the AFSMs are deployed. Allied labor costs are addressed at the conclusion of this section.

at all facilities." When confronted with Unger's testimony that "the potential volume of suitable mail will be greater than the capacity of the machines to be deployed . . . ", Tr. 38/17169, Patelunas had this response:

> A I don't think that he was wrong. I think that that said the initial deployment. What I'm looking at is the entire test year in all of the machine in all of their operations.
>
> And it would be reasonable to deploy a machine, a number of machines, where there is excess capacity, to try and -- or excess volume, and try and use all of that volume.
>
> As you get down towards the end of the deployment, that same, that initial volume may not be in all of those facilities.

Tr. 38/17169-70. This explanation is responsive to the literal answer of Unger but it ignores the implications of broader aspects of Unger's testimony. For example, he offered the following standard as the test for placing automation equipment in facilities:

> COMMISSIONER OMAS: Yes. In other words, what do you have to demonstrate, or what does a plant have to demonstrate to you in order to get an additional FSM?
>
> THE WITNESS [Mr. Unger]: It would be a couple of things; Number one, the equipment that they have existing in their plant would have to be at full utilization, which we track on our daily piece count.
>
> And at the same time, we'd have to show that the capacity is there, both on managed mail and incoming mail, that there's too much volume for the present capacity. And that can be shown just with our volume figures.
>
> When it shows that we can fully utilize another piece of equipment, that plant has reached its capacity and needs more equipment, then we would move it in, but it would have to be based on mail volume.

Although Unger was talking about "additional" flat sorting machines, it is difficult to imagine that the same standards would not apply to a facility receiving its first flat sorting machine.

It was Kingsley's testimony that utilization of the Phase I AFSMs would be uniform throughout the system, running approximately twenty hours per day. Kingsley reflected the saturation-like phenomenon suggested by Patelunas only in application to Phase II, suggesting that these machines would run fewer hours per day. Tr. 5/1961. The program to advance the purchase of the Phase I machines makes little sense if the Postal Service does not believe that it will have sufficient need for the machines in the Test Year. *See* USPS-LR-I-126 at 6.

It is also the case that the AFSM is expected to have two functions. It will replace manual sortation but it will also be used to increase the efficiency of sortation that had previously been performed by the FSM 881, with the 881s distributed to smaller facilities. *Id.*; Tr. 5/1983. If it becomes clear that there is not enough volume to utilize the AFSM 100s fully, the retirement of 881s could be advanced, as 551 of these machines will be fully depreciated at the beginning of the Test Year. Tr. 7/3014. All of the evidence in the case, other than Patelunas' conjecture on the subject, suggests that there will be an ample volume of flats in the Test Year to realize the cost savings projected by Buc.

C. Conclusion

The Buc calculation of AFSM cost savings should be adopted and the Postal Service proposed revenue requirement should be reduced by $202,131,000.00 to reflect the increase in Test Year savings that Buc's AFSM testimony establishes.

V. CONCLUSION

For the reasons stated, the Commission should reduce the Postal Service's estimated revenue requirement for the Test Year by no less than $1.3 billion.

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September 13, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with the Commission's Rules of Practice.

Dana T. Ackerly II

September 13, 2000